An Assessment of Challenges and Issues For Cost Recovery Initiatives within the Health Portfolio

FINAL REPORT

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1.0 Purpose of the Project

To identify the priority issues within the Health portfolio in the design and implementation of cost recovery programs, and to suggest a set of issues that should be covered in the planned review of the cost recovery policy by the Treasury Board Secretariat (TBS).

2.0 Background and Approach

Since 1995, cost recovery initiatives have presented program managers within the Health portfolio with many new management and administrative challenges. Many of these challenges reflect the growing pains of working with changing expectations on the part of the clients, stakeholder and program managers, and from working with the requirements and constraints of federal government policies, regulations and legislation.

A main objective for this project was to "ground-truth" these challenges for programs within the Health portfolio. Are program managers concerns about these challenges legitimate? If so, how much of an impact have the challenges really had on cost recovered programs? What obstacles are there to resolving these issues internally, within the Health portfolio? Which issues need to be resolved by TB? What options are there for Health Canada to improve the situation for its cost recovered programs?

To accomplish this task, RIAS Inc. conducted background research into the relevant cost recovery and financial policies that Health Canada and the Hazardous Materials Information Review Commission (HMIRC) must follow in establishing cost recovery initiatives.

Based on this background research, preliminary interviews with officials as well as our

own experience advising both government and industry clients on cost recovery issues, RIAS Inc. prepared a structured list of issues and questions for interviews with senior officials within cost recovery programs at Health Canada.
The purpose of the interviews was to:
identify the priority issues from the perspective of managers of cost recovery initiatives;
determine indicators of the impact of the issue on cost recovery initiatives within the Health portfolio and the priority for resolution of the issues;
determine, for each issue, whether it could be resolved by the department on a portfolio basis or whether the issue required Treasury Board resolution; and,
if the issue required Treasury Board resolution, suggest how the issue should be stated in the cost recovery review by the Treasury Board Secretariat.

Officials from the following programs were interviewed over a 3-week period:
Therapeutics Products Programme (TPP);
Pest Management Regulatory Agency (PMRA);
Occupational Health and Safety Agency (OHSA);
Food Program;
Business Development for Health Protection Branch Program; and,
Hazardous Materials Information Review Commission (HMIRC).

RIAS Inc. then met with officials from the Office of the Auditor General and the Treasury Broad Secretariat to seek their views.

3.0 Format of this Report

There are two parts to this Report:

- PART I - Health Canada: this part of the Report will focus on programs within Health Canada's departmental structure.
- PART II - Hazardous Materials Information Review Commission: this part of

the Report will focus on HMIRC.[1]

Part I contains the following sections: Context, A Summary of Observations from Program Managers, Assessment of Cost Recovery Issues, and Conclusions.

In *Context*, we discuss some of the realities facing Health Canada cost recovery programs, and the challenges of the future. One theme that emerges from this section is that solutions to cost recovery issues should focus on ensuring future success, not dwell on problems of the past.

In *A Summary of Observations*, we highlight the key concerns raised during our interviews with Health Canada program managers. This is followed by *An Assessment of Cost Recovery Issues*, where we examine the main issues identified during our research and present options for dealing with each issue. These options are not necessarily restricted to sending the issue to Treasury Board for consideration. The department has, in some situations, the appropriate mandate and tools to consider the issue on its own.

Under *Conclusions* we present the most important cost recovery issues and discuss the pros and cons of referring these issues to Treasury Board for consideration in their review of the cost recovery policy. In a number of instances, we conclude that the cost recovery issues should be considered first by Health Canada.

Part II of this Report follows a similar structure in examining cost recovery issues for the Hazardous Materials Information Review Commission.

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[1] HMIRC operates as an independent agency reporting to Parliament through the Minister of Health - a separate department under the Financial Administration Act (FAA).

PART I: HEALTH CANADA

4.0 Context

4.1 Health Canada's Cost Recovery Programs As Market Regulators

The majority of Health Canada's cost recovery programs are based on regulatory activities that have an amalgam of objectives, the most important of which is to protect public health and safety. For programs such as TPP and the PMRA, health and safety objectives are met by controlling the access to markets. This is achieved through scientific reviews of product safety and efficacy, and through ongoing compliance and enforcement activities such as annual product and site licensing. Cost recovery in these instances is based on delivery of mandatory services – the regulated parties must pay the fee and submit their products to review in order to get their products onto the Canadian market. Other programs charge fees for non-mandatory services.

Both types of programs (market access and fee for service programs) face similar challenges in terms of managing their resources under cost recovery. Cuts in A-base funding, fluctuations in workload, revenue shortfalls, limitations on revenue carry-overs, etc., all impact on these programs. Since both types of fee regimes have usually been instituted by regulation under authority of the Financial Administration Act, adjusting fees (either upward or downward) is also fraught with problems and delays.

However, market access programs face additional challenges. As the sole gatekeeper to the Canadian market, these regulatory programs face constant pressure from paying clients to improve their turnaround times. Other stakeholders raise concerns that standards of health and safety must be maintained. These

added pressures both complicate and compound the issues surrounding cost recovery for these market access programs.

4.2 The Technological and Market Environments of These Programs

Market access programs face the challenge of the accelerating pace of change in science and technology. For example, revolutionary changes are occurring in manufacturing processes. How do you regulate a drug that is "manufactured" within animal tissue rather than in a conventional laboratory? Advances in scientific measurement (i.e. the capacity to measure chemical residues in parts per trillion) may already exceed our ability to interpret the meaning or implication of such results. It is hard enough for the private sector to keep up to date on these issues, even when they drive much of the R&D. The task is even more difficult for knowledge-based public health and safety agencies when they are usually reacting to new scientific advances submitted for regulatory approval.

4.3 How Health Canada Got Into Cost Recovery In A Big Way And Why It Probably Doesn't Matter Now

It is generally acknowledged that Health Canada, like other departments, got into cost recovery too quickly, as a result of Program Review. The department did not really know what was involved, the practical difficulties, transition costs, etc. Many wish that the move to cost recovery had gone a different route, in particular that the new fees had been used to create new services or improve performance and with the annual appropriations continuing.

However, there is not much sense in dwelling on that history. The goals now should be:

- To ensure that the programs are equipped properly to deal with the challenges of the future;
- To take advantage of all flexibility arrangements that exist to enhance efficiency and effectiveness;
- To ensure that the department participates in the TB review to the extent that the review offers the possibility of useful, pragmatic change.

4.4 A Reality Check: The Cost Recovery Programs Continue to Function

The market access regulatory programs of Health Canada operate in highly charged arenas. Cost recovery has accentuated some of the public issues. Public stakeholders express concerns that the move to cost recovery may have introduced biases and unwelcome pressures on the department's scientific and technical staff. The affected Canadian businesses are concerned about the economic consequences to them of the cost recovery programs not meeting the performance standards agreed to at the time of implementing cost recovery. The intensity of the public debate on these two topics alone points to the charged atmosphere. However, it is important to begin this review of cost recovery issues by pointing out that the programs continue to function. Even in the cases of significant shortfalls in cost recovery revenues, the department makes up the deficit in its year-end allocations of resources to enable the programs to continue.

5.0 A Summary of Observations from Program Managers

The main points raised during our interviews with Health Canada program managers are provided below, organized by the main topics of the interview guide (see

Appendix A).

5.1 The cost recovery policy and mandatory programs

Most managers that we interviewed felt the current policy does not provide enough guidance for applying fees to mandatory programs. Some characterized the implementation of cost recovery as a fundamentally flawed, and that some programs should not have been cost recovered. Some opined that fees should be used only to improve performance, not to replace lost A-base funding.

Some officials noted that government programs have been set up to deliver benefits to the public, not to industry. Concepts like "user pay, user say", defining industry as clients, and responding to market signals have been a hard sell within a number of mandatory regulatory programs and with their clients.

One manager indicated that while the cost recovery policy speaks of increased efficiency/performance, implementing fees involves many "hoops" and may have led to a loss in program efficiency. Other officials pointed to cultural problems – the difficulty in getting government staff to recognize the new business realities of managing programs with cost recovery in place, from clerks who process cheques to senior managers making resource allocation decisions.

One HC official presented another point of view: that it was "too easy to cast stones at TB" over cost recovery. While acknowledging that cost recovery got off to a bad start, the sense was that departments could do a better job in adapting to the current cost recovery policy.

5.2 Determining costs of services delivered

There were diverging views on whether the cost recovery policy and related guidelines provide adequate direction on how costs should be determined. For some managers,

all activities should be eligible. The rationale used was that since industry actions cause the need for regulatory programs, virtually all activities are of a private benefit nature. However, there was not unanimous agreement on this interpretation among HC officials.

Most managers agreed that the cost recovery policy and the Guide to the Costing of Outputs provided reasonable guidance. In some cases it was noted that there have been disagreements with clients on what costs should be included, and that clarity and consistency was a concern in costing exercises. While most officials were comfortable with their approach to costing, concerns were raised about costing of departmental overheads.[2]

A number of officials agreed with the Auditor General that departmental accounting systems did not provide the type of information required to cost activities properly. While some believed that direct costs were fairly easy to estimate, fixed infrastructure costs such as financial, HR, informatics were said to be much harder to estimate, track and control. Further, most managers admitted that actual costs, at the level of staff time, are almost impossible to determine. It was noted that splitting staff salaries across 10 or 15 activities is difficult, so prorating approaches are common. This problem has lead to what was called "expensive guessing".

5.3 Setting prices

Setting prices was identified as a concern. Managers noted that approaches to pricing (i.e. the private benefit share for similar

[2] These concerns are detailed in a paper by the Office of Revenue and Costing: *Report on Study of Health Canada's Levies and Charges*, March 26, 1999.

types of programs) differed across and within departments.

Managers felt that more guidance was needed for pricing mandatory regulatory services. For example, it was unclear to some managers exactly how less than full cost pricing could be justified under the current policy (i.e. on the basis of private/public benefit or overriding socio-economic considerations). It was also noted, however, that more guidance from Treasury Board on these points could be too restrictive.

Managers differed on their positions regarding the flexibility to introduce different service levels at different prices: some felt the current policy allowed for it, others did not. Some of the problems identified were:

- Faster, more expensive service could unfairly favor large companies;
- Offering fast-track services could result in major shifts in workflow that are difficult to manage due to lack of flexibility on staffing.

Examples of existing differential pricing include the fast track for drugs with significant benefit and faster/cheaper electronic submissions. One program has looked at regional pricing for their services.

Managers were unanimous in their concerns over the difficulties in revising prices up or down. The length of the regulatory process was the main stumbling block. Few other mechanisms to set or revise prices were offered.

5.4 Private/public benefit split

Many program managers identified this as a significant problem, especially with the mandatory programs. The cost recovery policy requires that fees be set on the

basis of costs and the level of private benefit conferred to paying clients. Some Health Canada managers believe that each and every program activity leads to a private benefit and that the cost recovery goal should be to charge all program costs to users. Others suggest that public benefits are paramount in that the public, first, is protected by the program activities and, second, then reaps the benefits of the approved products.

Managers recognized that their role as a monopoly service provider raised special problems. Most felt that specific advice and clarification was needed from Treasury Board about applying cost recovery to mandatory regulatory programs. For example, should a consistent level of private benefit be "set" for all mandatory regulatory programs? Managers were concerned, however, that establishing a set level of private benefit by either HC or TB could be problematic given the differences in program objectives, roles and activities.

5.5 Impact assessments

Most managers had experience with business impact assessments of their fees. Concern was raised about the usefulness of results, and whether industry responses were well considered and reasonable. One manager indicated that the business impact assessment didn't help – it was not based on actual sales data, underrepresented small business, and some of the estimates didn't turn out. While some good information came out of the impact assessment on fee design, it did not provide "the whole answer".

Managers questioned whether more guidance was required to specify at what threshold a business impact assessment was required.

Managers pointed to the difficulties that can arise from impact assessments. Impact assessments that suggest fees will unduly harm industry put program mangers "between a rock and a hard place". For example, program cost recovery targets were

set under Program Review, but if the impact assessment says they shouldn't proceed, what do they do?

5.6 Flexibility in financial management

Most managers felt strongly that they did not have enough flexibility in financial management. For example, Health Canada's "SAP" financial system has zero-tolerance on overspending, which can lead to cash flow problems for programs. Managers stated that they have responsibility for financial management, but not the control.

Managers were asked whether a revolving fund would allay some of these problems. While most felt a revolving fund would be beneficial, a number of managers indicated that TB has turned down their requests for such arrangements. Some managers pointed out that they are knowledge-based businesses and asked how do they could properly invest in critical knowledge and training without revolving fund arrangements.

Specified purpose accounts were identified as a potential solution, but concerns were raised about a "significant" lack of understanding of departmental financial officers in the application of such instruments. Managers felt that financial officers don't understand day-to-day program operations i.e. the need to do billing and collection quickly.

Managers believed that accrual accounting would alleviate some of their financial issues, but were concerned that it would take another 3 years to implement. The main solution offered was to eliminate the Resource Allocation Committee's "grab" on program carry-overs.

5.7 Stakeholder expectations/perceptions

The original expectations of cost recovery (improved performance, reduced costs,

more client-oriented service) were in most cases seen as unreasonable, given that programs had their budgets cut and cost recovery revenues were simply used to replace lost funding. In one case, clients expected a regulatory program to operate with half their existing budget while delivering services in half the time.

Some managers suggested that industry clients did not appreciate the complexity of operating government programs within a cost recovery framework. Others pointed to the conflict between public perception that industry influenced regulatory decision making with fees in place, and industry's "user pay, user say" rights in the cost recovery policy.

5.8 Flexibility in personnel management.

Personnel management was a major concern. Programs are expected to adjust their services in response to changes in market demand, but the ability to increase or reduce staff was viewed as very limited under government rules. Hiring full time staff to deal with short-term workload increases or one-off projects is a long process (job descriptions, classification, interviews, training). Limits on the term and dollar value of temporary or contract staff arrangements are also restrictive, and the specialized expertise required is hard to find on short notice.

5.9 Setting performance standards

Different program managers had different views on whether they were achieving performance standards. Others admitted that the required information systems to accurately monitor performance were not in place.

Some managers indicated that before external performance standards could be properly administered, internal targets needed to be set first. For example, internal departmental performance standards are needed for informatics support, HR, and financial services. Others indicated that industry needed to meet performance

standards as well for the system to work efficiently i.e. companies must prepare high quality submissions to receive faster service.

5.10 Dealing with Program Review cuts

Managers were unanimous that Program Review cuts made cost recovery more difficult to implement properly. It was generally agreed by HC officials that, while cost recovery fees reflect elements of program costs, the fees were set to generate the revenues required to replace the Program Review cuts. Some suggested that there was a need to start over i.e. without revenue targets. Most acknowledged that cost recovery got off to a bad start and there had been too much reliance on fees for program funding. As a result, the approach to implementing fees was not methodical. On manager stated that there had been "no science" in applying cost recovery to programs in Health Canada.

5.11 Other Issues

Managers were of the view that more specific guidance is required from TB on how to implement the concepts contained in the cost recovery policy.

One interviewee suggested that TB should to develop a better, more comprehensive decision support framework for cost recovery program managers. However, during the ensuing discussions, managers acknowledged that there might well be flexibility within Health Canada's existing administrative arrangements that had not been explored fully.

It was also noted that getting rid of some minor irritants for cost recovery programs might lead to major increases in program efficiency and productivity.

6.0 An Assessment of Cost Recovery Issues

This section assesses the key issues that came out of our research and presents some options for dealing with each. The nature of the issue, coupled with the potential options for dealing with it, are used in Section 7 to suggest whether the issue should be referred to the Treasury Board policy review or should be dealt with by the department.

6.1 Setting Fees Above Direct Costs and Changing Fees

Setting a fee above direct costs: The current cost recovery policy requires that fees be based on full costs of the program activities for which the fees are charged. In principle, fees cannot be used to "cross-subsidize" other program activities. Some program managers saw this as an impediment to designing fee regimes that reflect the value of services rendered. For example, some industries appear willing to pay a premium for faster turnaround times.

Some inter-related options to consider:

Request that the TB review explore a third definition of fees (currently under the FAA fees can be set for a "service" delivered or for a "right or privilege" conferred). The third definition would deal with regulatory fees for services that grant/restrict market access, and would establish greater flexibility in how fees are set, for example on the basis of willingness of clients to pay for differential service levels.

Under authority of the Health Canada Act, introduce performance-based fees. The industry could elect to pay these fees on top of the existing FAA-based fees to get guaranteed turnaround times (NOT guaranteed approvals). The additional revenues for each program could be tailored to meet program needs e.g. devoted to hiring additional reviewers, expanding the use of contract reviewers or some other program priority.

Set "tiered" fees under FAA or Health Canada Act. One base-level fee would be charged for standard service; another higher-level fee would be charged for "fast-track" reviews. Set fees on the basis of negotiation with fee-paying clients, arguing, perhaps, on the basis of average program-wide costs.

Changing fees: Changing fees established by regulation under the Financial Administration Act (FAA) is a time-consuming challenge, according to program managers. In order to change or modify fee structures, regulatory process requirements must be met (i.e. consultation with stakeholders, impact assessments, TB submissions, pre-publication, etc.). This can take up to two years to complete.. This was viewed as a significant barrier to the managers' ability to respond to market signals.

Some options to consider:

Fast track changes to fees: The regulatory process is a PCO responsibility, not TB. HC may wish to seek clarification from PCO whether minor changes to fee structures, especially non-controversial fee reductions, could be fast tracked through the regulatory process. HC would likely have to demonstrate to PCO that stakeholders supported the fee changes.

TB could be asked as part of their policy review to establish criteria for fast tracking changes to existing fee structures.

Set fees under the Health Canada Act: While the Minister of Health has authority under the Health Canada Act to set fees, this avenue has not been pursued in the past. This was attributed by HC officials to stakeholder concerns that fees set under the Health Canada Act would not be governed by the cost recovery and regulatory policies. A lot has changed in the years since that approach was taken and the stakeholders now may be more amenable to a more efficient approach using the powers of the department's Act.

6.2 Revenue Issues

Carry-over of revenues: A number of HC officials stated that their inability to carry revenues across fiscal years was a barrier to effective cash management in their programs. While this issue was often cited as an irritant, our research did not uncover specific examples of significant problems in this area i.e. inability to pay suppliers or

meet payrolls because of limits on carry-overs.

Treasury Board rules allow for carry-over of 5% of a department's total non-salary operating budget. Currently, the Resource Allocation Committee (RAC) of the department lumps together the carry-overs from all programs to fund department-wide priorities and shortfalls. Thus, shortfalls in the current year revenues of a cost recovery program are made up by the carry-overs from other programs.

It is unclear whether the move to government-wide accrual accounting will completely alleviate these problems, or even when accrual accounting will take full effect. In the short-term, HC may wish to consider the following options to address the carry-over issue:

Develop special considerations for carry-over and re-allocation of revenues for cost recovery programs, as opposed to the department-wide RAC process.

Establish special forms of banking, including revolving funds, for HC cost recovery programs. For example: a pooled department-wide revolving fund for all Health Canada cost recovery programs.

Revenue Shortfalls through Increasing Costs:

Even at low inflation rates, costs rise. Some cost increases, for example salary increases resulting from employee contract settlements, are covered through annual increases in a department's appropriations funding. However, for cost recovery programs, increases to appropriations funding cover only the appropriations portion of the program's total salary costs. Thus, over time, a program's resource base is declining unless the increase in appropriations is adjusted. While this may be a small part of the department's overall salary appropriations, over time the gap will widen.

Options to consider

Raise this issue with TB for their policy review.

6.3 Splitting Program Benefits between Public and Private Benefits

Each of Health Canada's cost recovery programs had to grapple with the problem of determining the split between public and private benefits at the initiation of cost recovery. In some cases, the issue was contentious. The Health Canada programs do not have a common approach on the issue. The cost recovery programs of other departments also vary considerably in the approach they take to splitting the benefits. The TB policy provides no practical guidance on the issue and the Bird/Tsiopolous paper[3] points to the difficulty of resolving these issues in practice for market access control programs.

The issue is a difficult question in public policy and it has been so for many years, especially for regulatory programs that control market access. Health Canada managers of these cost recovery programs probably have as much practical experience with the issue as any other group. They certainly have more experience than the TB itself.

Options:

Request that the TB policy review set clearer guidelines on acceptable private/public benefit split for regulatory programs that have mandates to protect health, safety and environment.

HC set internal guidelines for an acceptable split of private/public benefits for mandatory health and safety programs. Apply this guideline consistently across HC programs, and re-allocate appropriately the Health Canada A-base funding to the cost recovery programs..

Let individual cost recovery programs continue deal with the issue on their own.

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[3] User Charging in the Federal Government - A Background Document. Treasury Board of Canada Secretariat (undated), prepared by Richard Bird and Thomas Tsiopolous of the International Centre for Tax Studies at the University of Toronto.

6.4 Changing the appropriations/fees split

It is generally agreed by HC officials that, while cost recovery fees reflect elements of program costs, the fees were set to generate the revenues required to replace the Program Review cuts. In some situations, these cost recovery targets have never been met. This has led to continuing revenue shortfalls on the part of some cost recovery programs. Each year, Health Canada senior management must re-allocate departmental appropriations to cover these shortfalls. The issue is whether the initial revenue goals for the cost recovery programs were realistic, or whether they should now be adjusted (reduced, in most cases) to reflect the experience to date. Program managers suggest that the issue can be resolved by: increasing the department's appropriations for the cost recovery programs or increasing fee revenues (either by fee increases or finding new fee initiatives). The alternative, of course, is the status quo with the department continuing to make up the shortfalls each year.

Options to consider:

Refer the issue to the TB review. Recommend that departmental appropriations be adjusted appropriately once the review has demonstrated the significance of the continuing shortfalls and the impracticality of the current revenue targets for the cost recovery programs.

Health Canada adjusts, internally, the cost recovery revenue targets and thus eliminates the need to re-allocate each year to cover what will likely be recurring shortfalls in revenues.

Increase revenues through fee increases and/or introducing new chargeable activities.

Continue with the status quo.

6.5 Capital expenditures

At present, capital expenditures for cost recovery programs are part of the department-wide capital budget appropriations. However, some of the cost recovery

programs could serve their paying clients better if they made additional, or accelerated, capital acquisitions. Two possibilities are in the areas of information technology and high-technology capital equipment to assist in the scientific work of the department's review teams.

A cost recovery program in the Canadian Food Inspection Agency has already carried out a small capital investment initiative jointly with its business clients. While some difficulties were encountered, there may be useful lessons to be learned from that initiative.

Options:

Health Canada develops alternative ways for such incremental capital expenditures to be paid for by the users of the cost recovery programs, in parallel to the department's capital budget process.

6.6 Rigidities in Managing The Most Important Resource: Scientific and Technical Staff

The rigidities in human resource management affect the ability of the programs' managers to adjust to both increases and decreases in workloads.

Most cost recovery programs face fluctuations in workload both within and across fiscal years. A number of program managers indicated that they have developed a "pool" of contract expertise to handle temporary increases in workload. However, the ability of program managers to use contract or temporary staff to deal with short-term increases in workload is constrained by government limits on temporary staff assignments (120 days) and on short-term contracting authority (signing authority limit of $25,000). As well, the highly technical staff required to carry out these activities can be in short supply.

When workloads drop-off, the rigidities apply also in that program mangers cannot

reduce their high proportion of salary costs by releasing their full-time staff quickly.

These human resource rigidities are difficult to manage, especially when cost recovery programs are supposed to "respond to market signals" in areas where technology is changing rapidly.

Options:

Seek relief from some of the human resource/contracting rules set by TB and PWGSC (i.e. 120 day limit on temporary staff assignments, $25,000 cap on contracts).

Consider a pooled approach to the technical/scientific staff across HC cost recovery programs, for those staff with similar functions and expertise. The technical/scientific staff could rotate among the cost recovery programs, responding to changes in demand such as workload increases, backlogs etc. . We note that this seems to be one of the intents of the recently announced restructuring of HC. The affected staff might realize some job enrichment benefits out of this approach, also.

6.7 Performance standards and cost recovery programs

Most of Health Canada's cost recovery programs have not achieved the performance standards (especially turnaround times) that were agreed to at the initiation of their cost recovery. The program managers suggest that this situation is a result of inadequate resourcing. That is, promises were made to improve performance yet the program's resourcing has, at best, remained constant through departmental make-ups of revenue shortfalls. While there is some merit to this point, we note that our research did not uncover any examples of substantive or fundamental program changes designed to address the issue of performance. Some useful cost reduction and efficiency improvements have been made, but we have not encountered any overall re-engineering of the programs to improve efficiency.

Options to consider:

Re-set the performance standards. If the current performance standards are unlikely to be met through existing program resourcing levels, is there any benefit to leaving the standards the way they are? Of course, any attempt to lower the performance standards would probably encounter fierce resistance from the fee-paying clients. Many of these clients argue that achieving the performance standards is even more important to them than reducing or eliminating the fees themselves.

Health Canada or individual cost recovery program managers tackle this issue head-on by considering fundamental changes. An approach would be to answer the following questions: What would our program have to look like to achieve the performance standards? What changes would we have to make to look like that? Are those changes feasible within the personnel and financial management rules that govern a Federal department? If the changes were feasible, then they would be started and implemented over an appropriate time period. If the changes turned out to not be feasible, then it might be worthwhile to re-examine the standards or other aspects of the cost recovery initiatives.

7.0 Conclusions

In this section we list the issues that are important to the Health Canada program managers and their affected groups (such as the regulated industries). First we discuss the pros and cons of the principal of seeking from the Treasury Board additional direction on cost recovery issues.

7.1 Considerations

There are a number of things to consider before proposing that TB resolve issues through their review of the cost recovery policy:

Be careful what you wish for- you might just get it. A TB review could lead to more rules and guidelines to follow, further complicating life for cost recovery program

managers.

A number of issues, while appropriate topics for the TB policy review, are probably irresolvable. A prime example is the call to produce explicit criteria for determining public/private benefit splits in regulatory programs.

While many Health Canada officials believe that the source of their difficulties with cost recovery programs relate to lack of appropriate resourcing, the department received a substantial increase in funding in the 2000 Budget. Calls by the department for increased A-base funding for cost recovered programs may fall on deaf ears at TB.

A related point is that most of the issues rose by HC officials about cost recovery deal only with one side of the ledger – revenues. The view from TB could be that cost recovery programs have not demonstrated the fundamental re-engineering of their operations to address the other side of the ledger (i.e. reducing costs especially to meet reduced revenue targets).

- During the course of our research, we encountered some approaches that could be considered by Health Canada, without additional TB guidance, that could improve the efficiency and effectiveness of cost recovery within the department. The TB could be expected to enquire as to whether those approaches were being pursued also.

7.2 Issues for Possible Referral to TB

Here are issues for which it might be useful to refer to TB, keeping in mind the considerations listed above:

Recognize the unique nature of market access control programs, and define fees for such programs separately from the section 19. of the FAA, "fee for service" and section 19.1, "right or privilege" definitions.

Define explicitly the circumstances whereby fees above full cost can be charged, without using the FAA section 19.1 - "right or privilege"- approach.

Define explicit criteria for a "fast-track" regulatory process for altering fees.

Resolve the issue of increased cost recovery program costs that are not directly

controlled by departments' appropriations, such as increases in salary costs.

Explore special provisions for fees and/or charges to support capital investments. in cost recovery programs.

Provide clearer, more explicit guidelines for determining private/public benefit split with specific reference to fees charged by programs with health, safety and environmental protection mandates. However, we caution again that it is unlikely that any helpful outcome will result from further research into this issue by TB.

7.3 Issues That Could be Addressed by the Department

All of the issues listed in section 6.0 are of some concern to program managers, but as we pointed out, the department has some authority to address them. We list some actions below that the department could consider taking:

The cost recovered programs define in detail what they would have to look like in order to achieve their stated performance standards. They then identify the sequence of steps required to change from their current structure to the desired one. If the steps were not feasible within a Federal Government department, then the programs would work with clients to adjust their expectations.

HC adjusts its A-base allotments for cost recovery programs that have experienced chronic revenue shortfalls and that are unlikely to ever achieve their revenue goals.

Pool 5% of the non-salary budget carry-overs from cost recovered programs into a single fund to be managed by a sub-committee of RAC, and re-invested in cost recovered programs. Such finds could be devoted to issues of common concern such as development of performance tracking systems, invoicing systems, staff training, etc. Carry-overs above the 5% level for cost-recovered programs would continue to be devoted to broader RAC priorities.

Examine the possibility of pooling some or all of the scientific and technical staff of the cost recovery programs. Through this pooled approach, these valuable staff could temporarily be re-assigned to deal with short-term workload increases or outstanding workload backlogs. There could also be considerable job enrichment benefits from such an approach.

Ensure that all other staffing flexibilities have been identified and are being pursued aggressively across all cost recovery programs.

Determine the benefits and feasibility of special forms of banking, including revolving funds, for Health Canada cost recovery programs to deal with cash management difficulties. For example: a pooled department-wide revolving fund for all cost recovery programs. Treasury Board approval would ultimately have to be sought for any such innovation, but it would be beneficial to explore the idea beforehand.

Explore with fee-paying clients and other stakeholders the possibility of establishing performance-based fees under the Health Canada Act. Fees could be in addition to existing FAA fees or they could be new fee regimes that replace existing fee structures.

Determine whether there are other value-added services that the cost recovery programs could introduce to improve the revenue shortfalls.

Develop a departmental policy on appropriate private/public benefit splits for health and safety programs and apply the policy to all cost recovery programs.

PART II: HAZARDOUS MATERIALS INFORMATION REVIEW COMMISSION

8.0 Context

The Hazardous Materials Information Review Commission (HMIRC) operates as an independent agency reporting to Parliament through the Minister of Health - a separate department under the Financial Administration Act (FAA).

HMIRC has been charging fees since 1988, much longer than any other HC program. HMIRC's cost recovery initiative even pre-dates the first cost recovery policy issued by TB in 1989.

For 12 years, HMIRC has experienced chronic, annual shortfalls in revenue of about 75%. This situation is cited to Parliament every year, as HMIRC must seek funding from Treasury Board to operate their program.

9.0 Main Cost Recovery Issues

Cost recovery based on 100% of program costs: When Cabinet established HMIRC in 1987 with cost recovery targets set at 100% of program costs, no consideration was given at that time to delineating the level of public and private benefits derived from HMIRC's activities.

Cost recovery based on flawed workload estimates: HMIRC's fees were established in 1988 based on workload assumptions established with industry at that time. Seventy-five percent of the claims activity estimated by industry has never materialized leading to chronic revenue shortfalls. Since HMIRC operates as independent agency, and is not part of Health Canada's departmental funding authority voted by Parliament, any shortfalls in revenue are HMIRC's responsibility

to manage. Each year, HMIRC has had to seek additional funding from Treasury Board to operate their program. In fiscal year 1998/99, $463,000 in fees was collected, or only 23% of $2M in total program costs for HMIRC.

No attention paid to private benefit: The current cost recovery policy requires that only program costs related to 'private' benefit be recovered. There is a serious discrepancy between the current cost recovery policy of the federal government and HMIRC's mandated 100% cost recovery target:

- HMIRC has conducted an in-depth analysis of its program activities. In order to meet the 1997 cost recovery policy requirement to consider the private/public split of program activities, HMIRC conducted an extensive review of its activities to delineate the most reasonable split between private and public benefit. The assessment determined that the protection of trade secret information was a private benefit. Other activities, such as the review of MSDS information and dispute resolution activities of the Commission were deemed to fall within the domain of public benefit. Other Occupational Health and Safety agencies in Canada (provincial, federal and territorial) do not charge for activities related to MSDS information since they have determined that this activity is of public benefit.
- HMIRC has conducted detailed time utilization studies at micro-activity level to determine actual direct costs of delivering their services prior to their recent reorganization. Based on this costing review it has been determined that approximately 25% of direct time expenditure relates to activities deemed to be of direct private benefit. An interesting statistic in this respect is that HMIRC has been able to raise only about 25% of their total program costs in fee revenues. Clearly though, both the actual user revenues and the private benefits estimates are significantly different from the HMRIC cost recovery target of 100% set by the Cabinet in 1987.

10.0 Conclusions

HMIRC has unique and significant problems with its cost recovery program. Our conclusion is that a serious discrepancy exists for HMIRC between the current requirements under the government's cost recovery policy and the original Cabinet decision mandating a 100% cost recovery target for the Commission. For over a decade, HMIRC has not been able to attain the 100% self-funding goal and, in our view, this mandated 100% cost recovery target is not in compliance with the current cost recovery policy.

Options to consider:

- Status quo. The disadvantages of this option are:
  - HMIRC will have to continue to request funding from TB every year.
  - It is inconsistent with the TB cost recovery policy.
- HMIRC could seek TB approval to modify its funding arrangements to be in compliance with the current cost recovery policy. The advantages of this option are:
  - It would eliminate the significant discrepancy with the cost recovery policy.
  - It would reduce the possibility of challenges and friction with stakeholders.

11.0 Recommendation

HMIRC should seek TB approval to modify its funding arrangements to be in compliance with the current cost recovery policy. The new arrangements should be based on a more reasonable combination of cost recovery revenues and annual A-Base appropriations.

APPENDIX A: INTERVIEWS AND INTERVIEW GUIDES

Interviews

Andy Butterfield, TPP
Weldon Newton/Sharon Watts/Ron Hay, HMIRC
Gillian Lynch, OHSA
Bob Woods, PMRA
Richard Viau, International Programs
Gord Laing, Food Program (referred RAIS Inc. to BVD)
Jean Breton, BVD (contacted, not available during interview period)
Brian Glabb/Derek Treherne, Office of Revenue and Costing
Orvel Marquardt, CSB
Neil Maxwell/Gordon Stock, OAG
Len Endeman, TBS

Interview Guide for Program Managers

PURPOSE OF THE PROJECT:

To identify the priority issues for Health Canada in the design and implementation of cost recovery programs, and to suggest a set of issues that should be covered in the planned review of the cost recovery policy by the Treasury Board Secretariat (TBS).

PURPOSE OF THE INTERVIEW:

- To identify the priority issues from the perspective of your cost recovery initiative;
- To determine indicators of the impact of the issue on your and other Health Canada cost recovery initiatives and the priority for resolution;

- To determine, for each issue, whether it could be resolved by Health Canada or whether it requires Treasury Board resolution; and,
- If the issue requires Treasury Board resolution, how the issue should be stated in the cost recovery review by TBS.

A PRELIMINARY LIST OF POTENTIAL COST RECOVERY ISSUES

This preliminary list has been prepared simply to stimulate discussion. The list comes from early discussions with departmental representatives and others with background in the field. We expect that issues will be deleted, added, combined and changed as the research proceeds. If you have a convenient way of packaging the issues (e.g. design vs. implementation, Health Canada vs. Treasury Board, etc.) please use it in the discussion. For each important issue you identify, we would also like to discuss indicators of the impact of the issue on your program.

1. **Determining whether mandatory programs should be/are subject to the cost recovery policy.**

   Does the current policy provide enough guidance with respect to charging fees for mandatory (monopoly) programs?

   Should there be different cost recovery rules for these mandatory programs?

2. **Determining the costs of services delivered.**

   Do the policy and related guidelines provide adequate direction on how costs should be determined?

   Is it clear to you which activities should be counted in the costs - all, only those that have a direct private benefit, some other basis?

   What costs or approaches to costing your activities have been particularly difficult to defend?

   Are there program costs that you can't include but feel you should?

   Does marginal cost pricing make sense in your program?

3. **Setting prices.**

   Once the cost is known, is it clear how to set the price?

In what circumstances should less than full costing be applied i.e. private/public benefit, socio-economic considerations,?
Is it clear how such considerations should be applied to setting prices?
What other considerations should be included?
Do you have the flexibility to introduce differential service levels at different prices? If not, is the difficulty with the clients, other stakeholders, the Department, or the cost recovery policy?
Is there enough flexibility to set/revise prices up or down? If not, is the difficulty with the Department, Treasury Board, the cost recovery policy, or the regulatory process? Is there a need for a simpler way, perhaps by introducing the cost recovery initiative other than through the FAA? Did you consider such an approach?

4. **Usefulness and practicality of private/public benefit split.**
Does the idea of a public-private benefit split make sense for mandatory regulatory programs that have a monopoly?
If so, should it be a "yes-no" question or should fees be proportional to the private benefit split?
How should the split be determined in practical situations?
What practical difficulties did you encounter in determining the split and applying it to set prices and other program parameters? Would better guidance have helped? If so, should that guidance come from TB, from Health Canada or elsewhere?
Should all programs that produce private benefits be cost recovered? (Are there any that produce private benefits but do not have cost recovery?)

5. **The design and usefulness of ex ante impact assessments.**
Is it clear how to carry out and react to impact assessments done when cost recovery is introduced?
Did you carry out detailed impact assessments?
Did the impact assessments provide the information you needed to set prices and

other design features of your program?

6. Flexibility in financial management.

Do you have enough flexibility in financial management? Are there issues in:
- Carryover of revenues across fiscal years?
- Debt settlement?
- Accounts receivable at end of year?
- Acquisition of capital equipment?
- Other?

Would a revolving fund allay some of these problems? If so, have you considered it? What happened?

Are there other potential solutions? Within TB rules? Within HC?

What effect, if any, will *accrual accounting* have on these issues?

7. Conflicts in stakeholder expectations/perceptions.

- Were the original expectations of cost recovery (improved performance, reduced costs, more client-oriented service) reasonable?
- To what extent have these expectations been met? Can they be met?

Have there been particular difficulties in managing the perceptions of non-paying stakeholders, especially in the sensitive mandatory programs?

Has it been difficult to manage conflicts between client needs and stakeholder concerns? Could a redesign of cost recovery improve the situation?

Have you established advisory committees and appeal mechanisms for cost recovery? What difficulties have you encountered?

8. Flexibility in personnel management.

Do you have the necessary flexibility over personnel resources (full-time and temp staff, contract personnel, etc.) to manage an operation with cost recovery in place?

Can you respond to market signals? Or are fixed costs too high and difficult to change i.e. hire additional staff, contract personnel to handle short-term

workload increases? Are there better designs of cost recovery that could improve the situation?

What effect does cost recovery have on the "culture" of your organization? How have staff and management reacted to cost recovery?

9. Setting program management/performance standards

Can you meet the policy requirements (and clients' requests) for program performance standards? If not, why not? Are there better cost recovery designs that could improve the situation?

Have you encountered difficulties in monitoring and meeting performance standards that you set?

Is there a need for incentives in cost recovery programs for good performance? At what level: branch, program or individual? Have you tried to introduce them? With what result?

Dealing with Program Review cuts

Were the revenues lost through Program Review cuts too large to be made up through cost recovery?

Did Program Review cuts make it difficult to meet the requirement to use the fees to improve services?

Is there a need to start over i.e. without revenue targets?

Other Issues.

Are there other issues that have not been covered above?

Interview Guide Concerning Cost-Recovery Resource Management And Authorities

Purpose

The purpose of asking these questions of the Corporate Services Branch is to ensure that we understand the real issues confronting the cost recovery programs of Health Canada and that we can assist the Health Canada client to put the right issues to the Treasury Board in its review.

Note that the questions relate only to the *mandatory regulatory programs* of Health Canada that are cost-recovered. Typically, these are product/substance approval programs that provide or deny market access.

Cost-Recovery Revenues

Changing fees

- Does it require a regulatory initiative to change fees for the Health Canada cost recovery programs? Or, could the Minister set new fees by fiat? If so, how and under what authority? If not, what limits this authority?

Carry-over of revenues

- Are there specific examples of significant problems caused by inability to carry revenues across government fiscal years? (Example of a real problem- inability to pay suppliers or meet payrolls, etc.) Did the 5% non-salary carry-over provision help the problems? What were the practical implications of the problems?
- Has the Department considered developing special considerations for carry-over and re-allocation of revenues for cost recovery programs, as opposed to the Department-wide RAC process? If so, with what result?
- Has the Department considered establishing special forms of banking, including revolving funds, for its cost recovery programs? (For example: a pooled Department-wide revolving fund for all cost recovery programs.)
- Will the introduction of accrual accounting make any practical difference to the cost recovery programs over the next 3 years?

Setting a fee beyond direct costs

- Could a cost recovery program in Health Canada introduce a new, discretionary, higher service level and charge more than the direct cost, arguing, perhaps, on the basis of average program-wide costs? (That is, provide a subsidy to the rest of the program?)

Changing the appropriations/fees split

- Would the Minister have, in theory, the authority to, for example, increase the allocation from the Health Canada appropriations total to a cost recovery program? For example: does the Minister have, in theory, the authority to increase, say, the TPP appropriations from $20 to $25, without having to demonstrate a reduction in the fee revenues?

Capital expenditures

- At present, capital expenditures for cost recovery programs are part of the Department-wide capital budget appropriations. Yet some of the cost recovery programs could serve their paying clients better if they made additional, or accelerated, capital acquisitions. Is there a way for such incremental capital expenditures to be paid for by the users of the cost recovery programs, in parallel to the Department capital budget process? If so, does Health Canada have the authority to do so or is authorization from elsewhere required?

Authority to establish and eliminate cost recovery of programs

- Could the Minister decide unilaterally, in theory, that a Health Canada cost recovery program such as TPP or BVD would no longer be cost-recovered, but funded totally out of appropriations? What route would be followed to do so?
- Are there programs in Health Canada that deliver private benefits but that do not charge the users? Is this a concern to Health Canada management?

The arithmetic of cost recovery

- Even at low inflation rates, costs rise. Yet none of the cost recovery programs

recovers 100% of costs and it appears to be difficult and time consuming to raise fees. Thus, over time, a program's resource base is declining unless the appropriations increase disproportionately. Has this been an issue to date? When will it become one?

Fixed costs of personnel

- Government units have a high proportion of fixed to variable costs. And it takes a long time (years) to reduce the fixed costs (mainly personnel) in government. Yet the cost recovery programs are supposed to "respond to market signals" in areas of technology that are changing rapidly. Has this been a resource management issue to date? Are there other ways of dealing with it, such as pooling all cost recovery technical/scientific staff?

Performance standards and cost recovery programs

- Most of Health Canada's cost recovery programs have not achieved the performance standards (especially turnaround times) that were agreed to at the initiation of their cost recovery. The program managers suggest that this situation is a result of inadequate resources. Comments?